



Transport for London

FINAL INTERNAL AUDIT REPORT

New Bus for London
Manufacture and Supply
(IA 12 629/F)

Leon Daniels, Managing Director,
Surface Transport

**Audit Conclusion: Adequately controlled
and Audit closed**

3 July 2013

Number of issues	
Priority 1	0
Priority 2	1
Priority 3	0

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EXECUTIVE SUMMARY

Introduction and background

In his 2008 election manifesto, the Mayor of London stated his intention to introduce an iconic new bus for London as a replacement for the old 'Routemaster' buses.

Following his election, in 2008, TfL ran a competition to harvest ideas and concepts for the design of this new bus. The competition joint first prize was awarded to Capoco Designs Ltd and a collaborative entry from Aston Martin and Foster & Partners.

In 2010, as the result of a competitive procurement process, a contract for the design, development and production of an initial batch of new buses was awarded by TfL to Wrightbus Ltd. Wrightbus was contracted to supply and maintain a total of six pre-production vehicles, for a total cost of £7.79m, with the intention for TfL to use these buses to pilot the New Bus for London operation and thereby prove the design's viability in service. The contract was constructed to cover subsequent supply and maintenance of up to 1000 production buses should the pilot be deemed successful and the decision for full implementation be taken. A variation was subsequently agreed to build a further two buses.

The pilot was judged successful, and in his 2012 manifesto, the Mayor stated his intention to order 600 buses into service by April 2016. Since then, TfL has been negotiating terms with Wrightbus for the full production order.

There have been some design changes to the buses as a result of the pilot, and this has impacted on their price. A key part of the negotiation has been on the final unit price.

TfL is obliged by the original contract awarded in 2010 to source production buses from Wrightbus up to the limit of 1000, after which TfL would have the option to source them from elsewhere.

Wrightbus is a well established supplier of double-decker buses, the second largest in the UK. Despite its prominence within the bus production industry it has only limited assets.

To assist Wrightbus to mobilise for the production order, TfL agreed to make an advance payment, with the sum being repaid through a discounted price per bus for the initial deliveries. At the time of our fieldwork, the exact sum to be paid in advance, the number of buses and period over which the sum would be repaid, and the way in which Wrightbus would use the sum had not been finalised. Since then a sum of £22m has been agreed and paid.

The final price for the bus, delivery schedule and terms of the advance payment are being captured within a variation to the original contract. Since fieldwork was concluded the final cost of the production order has reduced from £224 to £213m.

Objective

To provide assurance on the effectiveness of the arrangements for the manufacture and supply of the New Bus for London.

Scope

The audit considered the following areas of the contractual arrangements for the production and delivery of the New Bus for London. These areas included:

- Organisation and governance for the management of the contract
- Management of Memorandum of Understanding (MoU) obligations
- Management of additional obligations in respect of operations of the buses
- Management of the Change Control process
- Financial controls and payments
- Risk management
- Handover process to the operators

Summary of findings

All aspects of the scope were examined during the audit and any areas not mentioned specifically in this report were found to be satisfactory.

We noted that the methods followed during the assessment of the initial eight buses provided by Wrightbus Ltd were comprehensive, thereby giving assurance over the suitability of the bus for production.

We did not identify any priority one issues, but did identify one priority two issue (see Appendix 2 for definitions of issue priority ratings). The issue was that the risk register did not accurately record all significant risks associated with this project, and therefore did not describe all of the actions we would anticipate to be taken to mitigate all such risks. This issue is described in the detailed findings section below.

The timing of this audit resulted in preparation of this audit report being completed after the point at which the contract variation with Wright Bus had been signed and delivery of production buses had commenced. We therefore

carried out a brief follow up review, concluding that the agreed actions for the one issue had been satisfactorily addressed.

Conclusion

Based upon the audit findings we concluded management of New Bus for London manufacture and supply was adequately controlled and, since the one issue identified has already been addressed, this audit is now closed.

Follow up

No further follow up review will be necessary.

We would like to thank all those who were involved in and contributed to this audit.

DETAILED FINDINGS – PRIORITY 2 ISSUE

1. Risk Register

Issue

Although from its inception the project had maintained a risk register, it had not always been kept fully populated with the full spectrum of risks faced by the project, and with adequate mitigation plans. In particular, the register did not contain full details of the commercial risks that TfL faced in entering the full production phase of the project.

There were three areas of commercial risk that we believed should be comprehensively covered in the risk register, as follows:

1. Payments;
2. Financial surety; and
3. Proprietary Title.

Payments

As stated above, TfL agreed and made an advance payment of £22m to Wrightbus prior to any delivery of production buses. At the time of our fieldwork, the terms under which this payment was to be made were not fully defined. For example, Wrightbus's intended use for this money was not clear, and therefore the value to be gained by TfL in making this payment was not known.

There was a risk that having agreed to make this payment, TfL's commercial negotiating position could have been weakened, and that its anticipated value may not be realised.

Management advised us that following the conclusion of fieldwork related to this issue there had been negotiations and a memorandum agreement which negated this as a risk.

Nevertheless, although management were aware of this risk, and were seeking to address it during negotiation of the contract variation, the absence of a documented management plan did not give confidence that it was being managed as effectively as it could be.

Financial Surety

Wrightbus is a well established supplier of double-decker buses, the second largest in the UK.

The company is part of a group which have few assets and furthermore the company's bank is Bank of Ireland, which is financially classified as having 'junk status'; this official classification status having been widely reported following

the financial ratings published by Moody's, Fitch and this term was stated by TfL Finance during the audit fieldwork.

It is emphasised Wrightbus has a good reputation as a bus supplier, but nevertheless, there is a risk that during the life of the contract it may become unable to fully honour its obligations. The company's lack of assets will limit the extent to which TfL would be protected from loss in these circumstances.

More immediately, advance payment by TfL increases the level of financial risk until such time as it has been repaid.

Again, management were aware of this risk but it was not explicitly mentioned and assessed in the risk register, and there was a lack of clarity over how the risk was being managed.

Proprietary Title

As a result of the 2010 contract, TfL is wholly dependent upon Wrightbus for the supply of the first 1000 production buses.

Proprietary rights and charges on assets in production were initially not certain, potentially meaning that no rights existed if Wrightbus failed to deliver to the agreed schedule. Clarification and agreements have since been obtained to provide assurance that TfLs' rights are protected.

Once again, management recognised this risk, and we believe that the issue of rights has featured in negotiations throughout the project. However, the residual risk might have been significant and we believe required a specific entry in the risk register.

Risk exposure

Management should review the commercial risks for the production phase of the project, involving commercial and legal functions, and make specific entries in the risk register describing these risks, their levels and management action plans. The project manager should then actively monitor the execution of these management plans.

Management action plan

Agreed action	Manager responsible	Due date
The risk register has now been updated to include the risks surrounding a) the advance payment, b) the financial health of Wrightbus and c) the title of good and materials purchased with the advance payment.	David Hampson-Ghani	Addressed

The contract variation was eventually signed and by that time adequate surety had already been obtained regarding point a) and c) so these elements can be considered mitigated. The project team has committed to regularly reviewing at 2 month intervals the financial health of Wrightbus during the course of the contract.	David Hampson-Ghani	Addressed
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APPENDIX 1 – Distribution list

This report was sent to Leon Daniels, Managing Director, Surface Transport, by Clive Walker, Director of Internal Audit, and copied to:

Mike Weston	Operations Director, LBSL, Surface Transport (ST)
David Hendry	Director of Finance, ST
Simon Buxton	Chief of Staff, ST
Justine Curry	Head of Commercial Law, General Counsel
David Hampson-Ghani	Head of Projects, Operations and Group Safety, ST
Karlene Reid	as Key Risk Representative
Nigel Blore	Head of Group Insurance
Andrea Clarke	Director of TfL Legal
David Goldstone	Chief Finance Officer
Howard Carter	General Counsel
Robert Brent	KPMG

APPENDIX 2 – Definition of issues ratings

Priority 1

Significant weakness in the control environment which, if not addressed, have the potential to undermine the achievement of key corporate and/ or business area objectives. These weaknesses require urgent management attention.

Priority 2

Other control weakness that are less significant but still have the potential to threaten the achievement of corporate and/or business area objectives. These weaknesses require management attention.

Priority 3

While not necessarily a control weakness there is potential for process improvement by, for example, ensuring compliance with good practice, increasing process efficiency, identifying areas of 'over control', or strengthening the overall control environment by building upon the existing controls.